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A Short History Of Budgeting

by Dale L. Flesher and Tonya K. Flesher

Budgeting plays a prominent role in the practice of modern business administration. Such has not always been the case. Despite a long evolution, budgeting is essentially a twentieth century innovation. A brief study of budgeting's evolutionary period should provide modern budget personnel with a more appreciative perspective of their work.

The word budget is derived from the Latin word *bulga*, meaning leather bag or knapsack. Later the term was also applied to whatever was contained in the bag. The development of the modern meaning of the word goes back to early medieval France and to the days of the troubadours. These strolling players assigned to one of their members the task of handling funds of the company which were kept in a leather bag (*bougette*). This custodian became known as the budgeter. This simply meant that he supplied the funds for the group. Thus, the early definition of budget was that of a supply of something contained in a bag, or a supply of funds.

Governmental Budgeting

Even though the term budget was not used until medieval times, the concept of budgeting can be traced to the beginning of history. The Babylonians and Egyptians employed elaborate systems of control over grain supplies and money. The Romans relied on estimates of income and expenses to assess a tax based on the ability to pay. Forecasts are even mentioned in the *Bible*.

English Beginnings

Little is known about the budgets of

the early Romans, Babylonians, and Egyptians. Consequently, the English are usually given credit for the first real budgets as they are known today. King Henry I, who reigned from 1100 to 1135, is credited with the first use of the modern budget. The modern budget of King Henry differed from the earlier control systems in that the common man had a voice in the financial matters. Thus, King Henry advanced the ideas of budgeting and democracy. Today, every leading country in the world utilizes the science of governmental budgeting. History reveals that any time this right to participate in the financial affairs of a government is denied, serious trouble results. The English revolution of 1688 was an example of this as were the American Revolution and the French Revolution.¹ Thus, budgeting is virtually synonymous with democracy in that the early connotation of budget related to the manner in which funds were supplied and democracy is concerned with "taxation with representation."

The early literature on budgeting is limited to the budgeting of public funds. The original purpose was to curb the extravagance of monarchs. As early as 1760, the English Chancellor of the Exchequer presented the national budget to Parliament at the beginning of each fiscal year. The budget was the Chancellor's report on national finances. The budget served to protect the people from excessive taxation in that the estimate of expenditures in the budget also had to include a recommendation as to methods of levying taxes that would be needed to

provide funds for the estimated expenditures. Thus, the English budget served two functions: to curb the spending of public officials and to control the king's power to tax. This procedure was an accounting control procedure over incomes and expenditures. The budget was primarily in the form of an accounting statement and was prepared by the officer in charge of national accounts, the Chancellor of the Exchequer. Thus, here was an early connection between accounting and budgeting.

The budget speech presented by the Chancellor of the Exchequer included an accounting for the past expenditures and an estimate of future expenditures with a proposal for a tax levy. The budget was then an outline of the ways and means of providing the supply of funds needed to meet expenditures and was a positive concept. To many, this concept of the budget has been transformed into a negative one of restricting expenditures. It is interesting to note that the British interpretation of a governmental budget to this day is that of providing revenues. The budget is not considered until after the estimates of expenditures have been made. In the United States, the estimate of expenditures is called a budget.

The New World

The first evidence of the use of a budget in the United States is the informal budgetary statement that was submitted by Alexander Hamilton, the first Secretary of State, on January 9, 1790, to the House of Representatives, as part of his document entitled *A Report on Public Credit*. That report included an estimate for the services of the current year. The first formal United States government budget was not to come until over a century later.

The various state governments adopted budgets before the federal government. From 1911 to 1919, forty-four states enacted budget laws.² Many cities and other municipalities had begun using budgets even earlier. Municipal budgeting was used extensively during the late 1890's as a result of public pressure in the larger cities. By 1920, nearly all American cities had adopted a budget system. These reforms were prompted as a reaction to the political gangs, such as Tweed in New York.

The public pushed for a national budget during the period from 1890 to 1920, but Congress refused to act. President Taft was the most vigorous

advocate of a national budget, but his one term in office was insufficient time to get a system adopted. It was not until 1921 that the federal government finally adopted a formal budget system. Up to that time the financial plan consisted of a collection of individual departmental requests. The 1921 act gave the President the primary responsibility for submitting a complete budget to the Congress and established the bureau of the budget in the Treasury Department. Charles Dawes was the first director of the budget.

The period just prior to the turn of the twentieth century was also the period when emphasis was first placed on the personal budget. Although Ernest Engel, a Prussian, had presented his four laws of family expenditure as early as 1857, it was not until 1899 that the first attempt in this country was made at household budgeting. In that year, Ellen H. Richards published *The Cost of Living*. Her work led the bureau of home economics of the Department of Agriculture to adopt the family budget as a major object of study.³

Business Budgeting

Planning is an important process in the business world. This process could be seen in Biblical times when Joseph, the Prime Minister of Egypt, forecast the seven lean years in his interpretation of a dream. The progress of planning in business has gone from dreaming to guessing and from guessing to scientific forecasting. Although some large businesses in the U.S. used budgets prior to World War I, these were only in certain areas or departments. The complete budget came later in the development. First, firms tried to limit the expenses which were felt to be luxuries, such as advertising, research, and personnel. Thus, the first use of business budgeting was for purposes of restricting expenditures — not measuring effectiveness.

After Frederick Taylor brought standardization to production costs through his work with time studies and test runs in 1911, production costs could be accurately computed and attempts were made to control the production process. Taylor's work in setting standards through his scientific methods constituted an important phase goes back to the early development of cost accounting. The efforts of industrial engineers to reduce costs made cost finding a matter of prime importance. Cost accountants were required to provide adequate cost

records. Next, these records had to be summarized for management, which led to experimentation in the design of cost systems. The development of cost accounting theories ultimately led to the idea of standard costs, which was a major factor in the development of business budgeting. Eventually, all operations of the business, not only production costs, were standardized. The preparation of budgets became more scientific. Thus, the early history of business budgeting is closely tied to the evolution of cost accounting and industrial engineering.

Scientific-Management Influence

The early period of development of business budgeting can be traced back to 1880 in the United States when a group of industrial engineers banded together to form the American Society of Mechanical Engineers. This group criticized traditional accounting and advocated other ways of measuring business results. Members of this band of advocates of scientific management included F. W. Taylor, Towne, Halsey, and Metcalfe.⁴ At the same time, accountants such as J. Whitmore, H. R. Hatfield, and others responded to this challenge. The first decade of this century was the most fruitful period for the development of management accounting through the promotion of reciprocal relations between engineers and accountants.

The early and fundamental idea of standard costs and business budgets was concurrently evolved by engineers during the first decade of this century. Henry Hess, an engineer, devised the fundamental ideas of profit planning supplemented with break-even analysis in 1903. Another engineer, C. U. Carpenter, in 1907, used Hess' concepts and originated the business budget idea (although he did not use the term budget). Carpenter originated the ideas of budgetary control and budget variance analysis. The appearance of these new viewpoints were closely related to the social and economic situation at that time which was marked by chronic overproduction and the recessions of 1903 and 1907.⁵

The period after 1920 has been one of substantial and rapid growth in the use of budgets. It was in 1922, when J. O. McKinsey published his *Budgetary Control*,⁶ that industrial budgeting received its biggest impetus. World War I and the resultant emphasis on efficiency provided adequate stimulus and McKinsey's work summarized all ex-

perimentation to date into a complete budget program for industry. His book was the first attempt to cover the budget program for industry. It was also the first attempt to cover the entire budgetary program.

Panacea for Depressions

It was the Great Depression which led to the widespread adoption of budgeting. By then, it became evident to firms of all sizes that budgeting was essential for profitability. The writings about budgeting were at their peak during the decade of the 1930's. Businessmen heralded the budget as the panacea for all economic ills. As a result, budgets were misused. There were arbitrary reductions of personnel and ill-planned and unrealistic cost reductions. In this climate, budgeting became enshrouded in an aura of negativeness. The budget became a symbol of oppressive action and resulted in bad experiences for many individuals. Much of the distrust and suspicion of budgets today may be traced to that period and the manner in which budgets were first introduced to many Americans.

Industrial engineers continued to contribute to the development of business budgeting in the decade of the 1930's. Most notable was John H. Williams whose book *The Flexible Budget* was written in 1934. This book was the first major publication to bring the concept of flexible budgeting to the attention of the manager. Williams separated cost accounting and budgeting into two separate subject areas. He contended that budgets are based on foresight, while cost accounting is based on hindsight. Thus, he said that a budget should be prepared so that any businessman can understand it without any knowledge of accounting.⁷ The true pioneer nature of this book can be appreciated even more when it is noted that in all of the publications of the National Association of Cost Accountants (NACA), only one reference appears on flexible budgeting prior to 1930 and only six references may be found prior to 1935. This is unusual because books are usually preceded by journal articles on the same topic. Another engineer, C. E. Knoepfel, employed the concept of a flexible budget in his book, *Profit Engineering*, published in 1933. Knoepfel called his concept a "Profitgraph." In its simplest form, the Profitgraph was merely the graphic presentation of a flexible budget.

During this same period, Walter Rautenstrauch published *The Successful Control of Profits* (1930). Rautenstrauch, also an engineer, is credited with the development of the breakeven chart.⁸

Wartime Priorities

The next stage in the development of business budgeting began with the start of World War II. The government sponsored defense programs began to shift emphasis away from cost control and to focus attention, instead, on the necessity of getting a job done. Production programs and delivery schedules became the keys factors in business planning. As material shortages increased, firms were forced into establishing some kind of an overall plan in order to meet production quotas. It was this period which brought about the emergency of the production planning and scheduling activity as a major part of budgetary control. As the war progressed and there was lessening of demand, interest again focused on production costs. The U.S. government, who was the major customer, began to indicate a growing interest in competitive bids. The ability to produce no longer was the prime requirement for obtaining a contract.

Additional evidence of the changing times was the movement for installation of standard cost techniques in government operated plants. Since there were salary and wage differentials in different parts of the country, the government needed to find some common unit of measure for comparing the jobs being done by competing facilities. A standard cost system proved to be the common denominator which leveled out the variations.

The Competitive Edge

Despite the increased emphasis on cost control, it was not until the end of the Korean War that most firms began to adopt a realistic appraisal of budget techniques. With the tapering off of post-war consumer demand, the necessity for reestablishing a firm competitive position became the major objective for most businesses. Also, a number of important by-products began to emerge from budget planning — the advantages of advance planning, the expansion of the budget idea into a master plan for coordinating all activities, and as a potential management tool. In the 1950's, there was more emphasis upon the extension and refinement of budget plans. Probably the major contribution to budgeting in the

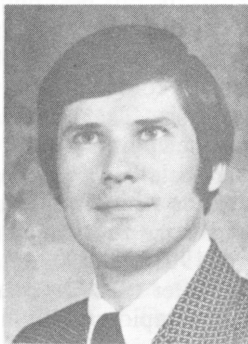
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1950's was the undertaking of behavioral studies in budgeting. Chris Argyris' book, *Impact of Budgets on People*, was the forerunner in this area.

The 1960's and 1970's have witnessed further refinements in the budgetary process. The most publicized of these has been the concept of zero-base budgeting. The first formal zero-based budgeting system was that used by the U. S. Department of Agriculture in preparing its 1964 budget. Its use in that department was temporary. Texas Instruments, Inc. was the next to utilize zero-base budgeting in 1969 and 1970. That firm is given the credit for developing zero-base budgeting in the form that is known today.⁹



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Summary

Though of rather recent acceptance, the seeds of budgeting were planted many centuries ago. The earliest budgets represented revenue plans for governmental bodies. Budgets became commonplace among American governmental units during the period from about 1880 to 1921. Cities were first to implement budget systems, followed by states and then the federal government.

The first two decades of the twentieth century marked the germination period of business budgeting. The seed was there and it was nurtured by industrial engineering and cost accounting. Business budgeting finally bloomed during the 1930's. However, the concept had changed somewhat from that of earlier decades. Whereas the first budgets were conceived as a positive concept where funds were supplied to cover expenditures, the budgets of the 1930's were seen in a negative manner where expenditures were eliminated.

World War II contributed to the development of budgeting in that material shortages and delivery schedules became as important as cost control. Recent years have witnessed contributions by behavioral scientists to the science of budgeting. Statisticians and economists have also played a role through research in the area of business cycles.

The study of budgeting history is an interdisciplinary study. Accountants, engineers, behavioral scientists, statisticians, economists, and politicians have all played major roles in the development of budgeting. A budget is a blend of many ideas. Perhaps future developments in budgeting will be derived from still other disciplines. ■

NOTES

¹Andrew S. Mihalik, "Ye Olde Budget," *Journal of Accountancy* (July, 1936), p. 54.

²Edwin L. Theiss, "The Beginnings of Business Budgeting," *Accounting Review* (March, 1937), p. 46.

³Mihalik, Op. Cit., p. 52.

⁴Atsuo Tsuji, "Shades of the Past — Budgeting in Early 1900's," *Managerial Planning* (March/April, 1975), pp. 23-29.

⁵*Ibid.*

⁶James O. McKinsey, *Budgetary Control* (New York: Ronald Press, Inc., 1922).

⁷John H. Williams, *The Flexible Budget* (New York: McGraw-Hill Book Company, 1934).

⁸Raymond Villers, "The Origin of the Breakeven Chart," *Journal of Bbusiness* (1955), pp. 296-297.

⁹James Pattillo, *Zero-Base Budgeting: A Planning, Resource Allocation and Control Tool* (New York: National Association of Accountants, 1977), pp. 1-2.